



BDO Seidman, LLP
Accountants and Consultants

June 2004

Issue:
**Research &
Development
(R&D) Tax
Credit Update**

Corporate Tax Alert

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Date/Timing:

The R&D tax credit is set to expire on June 30, 2004. Despite broad bipartisan support for a permanent extension of the credit, it appears that there will only be an extension of the credit based on budgetary concerns and timing.

Details:

On May 11, 2004 the Senate passed their version of the ETI/FSC (JOBS) bill. The bill provides for an extension of the R&D tax credit through December 31, 2005 and an Alternative Simplified credit which provides yet another option for calculating the R&D credit. Under this amendment the current rules would remain in effect through 2004. In 2005 taxpayers would have the option to utilize the existing rule or they could elect the Alternative Simplified method. The Alternative Simplified method obtains simplification by redefining a taxpayers base amount calculation. Instead of looking to the current base period tax years of 1984-1988, the amendment would take a company's average research spending for their three most recent years, multiplied by 50% to determine their base amount. A credit would be allowed for 12% of any current year qualified research expenditure in excess of the base amount. Additionally, this amendment would increase the rates for the current alternative incremental credit percentages for each of the three tiers from 2.65% to 3%, 3.2% to 4%, and 3.75 to 5% and includes a few additional enhancements that would apply to taxpayers that make payments to research consortia, federal laboratories or certain small businesses. The big win for some taxpayers would be the Alternative Simplified method. Taxpayers with relatively flat qualified research expenditures, no 1984-1988 base period cost/records, or high/increasing sales compared to qualified expenditures would benefit the most by utilizing the Alternative Simplified method.

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Details ...(continued)

Although the Senate version of the ETI/FSC bill is R&D favorable, the current House version does not include an amendment extending the R&D tax credit. Due to the contentious nature of this bill, it is almost certain that the final ETI/FSC bill will not be passed into legislation until after the congressional break. Additionally, it is likely that the R&D tax credit attachment may not make it through to the final version of the bill.

If the R&D credit does not get attached to the ETI/FSC bill, it is highly likely that we will see some type of extenders bill that will be passed sometime later this year (after the June 30 expiration date). Many Congressional leaders have stated that if this happens that they would like to see the credit be retroactive to the date of expiration so as not to create a lapse in the credit period. What the final extension amendment will contain is yet to be seen.

It appears that taxpayers utilizing the R&D tax credit will be left in limbo for a period of time after June 30. However taxpayers can take some solace in the fact that Congress has been vocal about their intent to extend and possibly simplify the credit. In a year where there is political focus on job creation, some action on the R&D tax credit expiration should occur.

FOR MORE INFORMATION

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